UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF TEXAS

IN RE ENRON CORPORATION SECURITIES LITIGATION	Consolidated Civil Action No. H-01-3624
This Document Relates To: MARK NEWBY, et al., individually and on behalf of all others similarly situated, Plaintiffs, v. ENRON CORPORATION, et al., Defendants.	
THE REGENTS OF THE UNIVERSITY OF CALIFORNIA, et al., individually and on behalf of all others similarly situated, Plaintiffs, v. KENNETH L. LAY, et al., Defendants.	

DECLARATION OF STEPHEN M. LOFTIN IN SUPPORT OF MERRILL LYNCH'S MOTION TO DISMISS THE AMENDED COMPLAINT

STEPHEN M. LOFTIN declares under penalty of perjury, pursuant to 28 U.S.C. § 1746, as follows:

1. I am a partner with the law firm Hicks Thomas & Lilienstern, LLP, counsel to defendants Merrill Lynch & Co., Inc. and Merrill Lynch, Pierce, Fenner & Smith, Inc. (together, "Merrill Lynch") in this action.

2. Attached hereto as Exhibit A is a true and correct copy of Merrill Lynch employee James Brown's notes, referenced at ¶ 742.10 of the Amended Complaint.

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3. Attached hereto as Exhibit B is a true and correct copy of the Securities and Exchange Commission Complaint filed against Merrill Lynch and four of its former employees on March 17, 2003.

4. Attached hereto as Exhibit C is a true and correct copy of the article from *The Wall Street Journal* first disclosing the Nigerian Barge Transaction on April 9, 2002.

5. Attached hereto as Exhibit D is a true and correct copy of the article from the *New York Times* first disclosing the Power Swaps on August 8, 2002.

I declare under penalty of perjury that the foregoing is true and correct.

Executed on June 18, 2003 at Houston, Texas.

Stephen M. Loftin

Investment Banking
Group
200 Crescent Court
Suite 550
Dallas, Texas 75201

J.BROWN
00372

Merrill Lynch

Facsimile Cover Sheet

Don Boyle

To: Jim Brown
Company: ML
Phone:
Fax: 212-449-1787
From: Rob Furst
Phone: (214) 849-5350
Fax: (214) 849-5399

Date: December 21, 1999

26 pages including this cover page.

Message

Paul Wood
2-6318

NIGERIAN TAX HOLIDAY - foreign Tax (income, w/h, VAT, etc.)
MAYBE - environmental
RISK - operating performance
RISK - failure to complete
YES NOT SURE HOW - expropriation
- failure to pay under PPA
(no PPA signed yet?)
- No repurchase oblig. from Enron
- foreign currency risk
- Enron credit/performance risk
- reputational risk if aid/abet Enron income stmt. manipulation

"A"

U.S. Securities and Exchange Commission

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF TEXAS
HOUSTON DIVISION

United States Securities and Exchange Commission, Plaintiff, v. MERRILL LYNCH & CO., INC., DANIEL H. BAYLY, THOMAS W. DAVIS, ROBERT S. FURST, SCHUYLER M. TILNEY Defendants.	Civil Action No. H-03-0946 (Hoyt) **COMPLAINT** JURY DEMANDED

Plaintiff Securities and Exchange Commission (the "Commission") for its Complaint alleges as follows:

SUMMARY

1. Merrill Lynch and its senior executives Robert S. Furst, Schuyler M. Tilney, Daniel H. Bayly, and Thomas W. Davis, helped their client, Enron Corp., commit securities fraud. In December 1999, at Enron's request, Merrill Lynch entered into two fraudulent year-end transactions that Merrill Lynch knew were designed to improve Enron's financial picture. As a result of these transactions, Enron fraudulently added $60 million to its fourth quarter 1999 income, a 30% improvement in net income. This allowed Enron to meet analysts' expectations about its performance, increase its earnings per share, improve its stock price, and boost its bonus pool for senior executives. For aiding Enron, Merrill Lynch earned millions of dollars in fees and believed Enron would continue to award it lucrative business in the future.

2. Merrill Lynch and Enron completed the two fraudulent transactions in the last days of December, 1999. In the first, an asset parking arrangement, Enron purportedly "sold" an interest in Nigerian energy barges to Merrill Lynch. In fact, the risk of ownership never passed to Merrill Lynch. Instead, this was in effect a short term loan and Merrill Lynch earned a specified rate of return. Pursuant to a side deal between Enron and Merrill Lynch, Enron took Merrill Lynch out of the transaction in June 2000. Enron reported, as

"B"

Merrill Lynch knew it would, $12 million in income from this sham "sale." In the second fraudulent transaction, Enron and Merrill Lynch entered into two energy option contracts that were designed to substantially cancel each other out. Enron agreed to pay Merrill Lynch a $17 million dollar fee for participating in what was essentially a risk-free transaction. Enron reported, as Merrill Lynch knew it would, $50 million in income from this sham energy trade.

3. Based on their substantial assistance to Enron, defendants aided and abetted Enron's violations of the federal securities laws. The Commission requests that this Court permanently enjoin defendants from violating the federal securities laws cited herein, bar defendants Bayly, Davis, Furst, and Tilney from acting as officers or directors of any public company, order Merrill Lynch to disgorge all ill-gotten gains, order all defendants to pay civil penalties, and order such other and further relief as the Court may deem appropriate.

JURISDICTION AND VENUE

4. The Court has jurisdiction over this action pursuant to Sections 21(d), 21 (e), and 27 of the Exchange Act.

5. Venue lies in this District pursuant to Section 27 of the Exchange Act [15 U.S.C. ' 78aa] because certain acts or transactions constituting the violations occurred in this District.

6. In connection with the acts, practices, and courses of business alleged herein, defendants, directly or indirectly, made use of the means and instruments of transportation and communication in interstate commerce, and of the mails and of the facilities of a national securities exchange.

7. Defendants, unless restrained and enjoined by this Court, will continue to engage in transactions, acts, practices, and courses of business as set forth in this Complaint or in similar illegal acts and practices.

DEFENDANTS

8. Merrill Lynch & Co., Inc., is a Delaware corporation with headquarters in New York, New York and offices serving corporate and institutional clients nationwide, including Houston, Texas. At all relevant times, Merrill Lynch's common stock was registered with the SEC pursuant to Section 12(b) of the Exchange Act and was listed for trading on the New York Stock Exchange (MER).

9. Thomas W. Davis, 49, resides in Scarsdale, New York. Davis was an Executive Vice President and the Global Head of Merrill Lynch's Corporate and Institutional Client Group from 1998 until October 2001, when he became Vice Chairman of Private Equity and Research. Davis was a member of Merrill Lynch's senior executive management committees from 1997 until 2002. Davis was terminated by Merrill Lynch on September 18, 2002, after he asserted his Fifth Amendment rights in Commission testimony on September 10, 2002.

10. Daniel H. Bayly, 55, resides in Darien, Connecticut. Bayly was Global

Head of Merrill Lynch's Investment Banking division from 1999 until 2001, when he became Chairman of Investment Banking. Bayly retired from Merrill Lynch in the Fall of 2002. Bayly initially testified before the Commission on July 10, 2002 but later declined to provide additional testimony requested by the Commission.

11. Schuyler M. Tilney, 47, resides in Houston, Texas. Tilney was head of the Houston, Texas office of Merrill Lynch's Global Energy & Power division within Investment Banking until 2001, when he was promoted to Global Head of the Energy and Power Group. Tilney was placed on administrative leave by Merrill Lynch in July 2002, and terminated on September 18, 2002. He asserted his Fifth Amendment rights in Commission testimony on July 31, 2002.

12. Robert S. Furst, 41, resides in Dallas, Texas. Furst was a Managing Director of Merrill Lynch and, during the relevant period in 1999 and 2000, was the Enron relationship manager for the investment bank. Furst resigned from Merrill Lynch in 2001. Furst asserted his Fifth Amendment rights in Commission testimony on August 21, 2002.

OTHER ENTITIES INVOLVED

13. Enron Corp. is an Oregon corporation with its principal place of business in Houston, Texas. During the relevant time period, the common stock of Enron was registered with the Commission pursuant to Section 12(b) of the Exchange Act and traded on the New York Stock Exchange. In 2000, Enron raised millions in the public debt and equity markets. Among other operations, Enron was the nation's largest natural gas and electric marketer with reported annual revenue of more than $150 billion. Enron rose to number seven on the *Fortune 500* list of companies. By December 2, 2001, when it filed for bankruptcy, Enron's stock price had dropped in less than a year from more than $80 per share to less than $1.

FACTUAL ALLEGATIONS

Earnings Pressure At Enron, Year-End 1999

14. In late 1999, Enron faced shortfalls in earnings. Failure to meet earnings targets for year end 1999 might have had a negative impact on Enron's stock price and the compensation of Enron's senior management. Enron sought to make up the earnings shortfalls. As part of this effort, Enron devised two transactions that had the purpose and effect of fraudulently inflating Enron's reported financial performance. Seeking a partner to assist it in this endeavor, Enron approached Merrill Lynch in December 1999 with the two fraudulent earnings schemes.

The Nigerian Barge Transaction B Asset Parking

15. In December 1999, defendants knowingly rendered substantial assistance to Enron in a fraudulent asset parking arrangement. This involved a "sale" of an interest in Nigerian barges that, as defendants knew, would allow Enron to record $12 million in earnings in the fourth quarter of 1999. The sale was a sham. The risks and rewards of ownership in the barges never passed to Merrill Lynch because Enron's CFO Andrew

Fastow guaranteed Merrill Lynch that it would not lose money and that it would be taken out of the deal within six months.

Enron Approaches Defendants With Barge Transaction

16. In mid-December 1999, Enron's treasurer contacted Furst about buying an interest in the Nigerian barge project. In the transaction, a Merrill Lynch special purpose entity ("SPE") would purchase stock in an Enron subsidiary called Enron Nigeria Barge Limited for $28 million. Ownership of the stock purportedly would entitle Merrill Lynch to receive certain future revenues from sales of power to Nigeria under a Power Purchase Agreement. Enron would provide $21 million of the purchase price to the Merrill Lynch SPE in the form of a loan that was non-recourse to Merrill Lynch. Thus, Merrill Lynch was asked to provide only $7 million in cash for the deal.

17. At the time Enron presented the transaction to defendants, there were significant questions about the value of the barge investment. The barges were still under construction and not yet operational in Nigeria. Various Nigerian government approvals had not been obtained, and Nigeria had not yet secured a $30 million Letter of Credit that was to serve as a guarantee for the government's performance under the Power Purchase Agreement. Further, given the short notice to defendants, they were unable to perform due diligence on the barge transaction. The transaction was unusual for the group at Merrill Lynch that would handle the transaction because, among other things, the group generally worked with domestic assets and structured lease transactions, and had no experience in dealing with Nigeria or Africa.

18. After discussing the transaction with Fastow and Enron's treasurer, Furst memorialized Enron's request in a memorandum dated December 21, 1999 to Bayly, Tilney, and others at Merrill Lynch. The memorandum stated that the transaction would allow Enron to book $10 million in earnings [later corrected to $12 million], and had to close by December 31, 1999. The memorandum also stated that Enron believed Merrill Lynch's "hold" would be for less than six months and the investment would have a 22.5% return (these terms were deliberately omitted from the operative transaction documents because they would have revealed the true nature of the transaction). The memorandum also noted that the transaction would permit Enron to record $28 million in cash flow. Furst strongly recommended that Merrill Lynch take part in the transaction because Enron was an important client.

19. In addition to the December 21, 1999 Furst memorandum, a document entitled "Appropriation Request" relating to the barge transaction was circulated within Merrill Lynch. This document also made clear that Enron and Merrill Lynch contemplated a side deal in which Merrill Lynch would be taken out of the transaction within six months at a specified rate of return. The document noted that the transaction (a) would allow Enron to book $12 million in earnings; (b) had to close by December 31, 1999; (c) would generate a return of $250,000 plus 15% per annum or a flat 22.5% per annum; and (d) required a $7 million financial commitment by Merrill Lynch. The document stated that Enron had "assured us that we will be taken out of our investment within six months" and that Enron would "facilitate" Merrill Lynch's "exit from the transaction with third party investors." The document added that Bayly would call senior management

at Enron "confirming this commitment to guaranty [sic] the ML takeout within six months." Finally, the document stated that Enron had "strongly requested ML to enter into this transaction," that Enron had paid Merrill Lynch approximately $40 million in fees in 1999, and was expected to do so again in 2000.

20. After the transaction documents circulated, various Merrill Lynch executives met and conferred regarding the transaction. Contemporaneous notes of individuals at Merrill Lynch with knowledge of the transaction referred to it as a $7 million "handshake" loan to Enron that would be repaid within six months.

Merrill Lynch Reviews and Approves Barge Deal

21. Furst and Tilney also began the process of getting approval within Merrill Lynch by talking to an executive who was the head of Merrill Lynch's structured leasing group. The Merrill Lynch executive told Furst he was not interested in the transaction because it was not a lease, it did not involve domestic assets, and his group had no experience in dealing with Nigeria or Africa. Tilney asked the Merrill Lynch executive to reconsider because Enron was an important client of Merrill Lynch and the transaction was very important to Enron. The Merrill Lynch executive agreed to run the transaction further up the chain of command at Merrill Lynch.

22. As part of this process, Merrill Lynch's "Debt Markets Commitment Committee" (DMCC) reviewed the transaction. In preparation for a meeting of the DMCC, an interoffice memorandum, dated December 22, 1999, was prepared and addressed to the committee. The document stated in part, "Enron will facilitate our exit from the transaction with third party investors. Dan Bayly will have a conference call with senior management of Enron confirming this commitment."

23. Prior to the DMCC meeting, Tilney and Furst called Bayly to discuss further the terms of the proposed transaction, as described above. The parties also discussed the fact that the transaction was very important to Enron.

24. At the same time, there was some dissension within Merrill Lynch about the transaction, including an internal document expressing concern that Merrill Lynch could be viewed as aiding and abetting Enron's fraudulent manipulation of its income statement.

25. The DMCC met on or about December 22, 1999. Furst presented the terms of the transaction, as outlined above, and emphasized the transaction was for an important Merrill Lynch client. Again, concerns were raised by certain individuals at Merrill Lynch about the propriety of the transaction, including whether Enron could properly treat the transaction as a sale, and whether Merrill Lynch could be viewed as aiding and abetting Enron's fraudulent manipulation of its income statement. The DMCC discussed the fact that Bayly was expected to call Fastow to make sure Enron appreciated Merrill Lynch's assistance, to confirm Enron's take-out, and to receive assurances of future business from Enron. The DMCC concluded it did not have authority to approve the transaction and that such approval would have to be given by higher authority, specifically Bayly or Davis.

26. Following the DMCC meeting, Bayly, Davis and Merrill Lynch executives who attended the DMCC meeting met to consider the transaction. The parties discussed, and Davis was fully aware, of the terms of the transaction, including that: (a) Merrill Lynch would purchase its interest in the Nigerian barges for $28 million; of this amount, $21 million would be provided by Enron to Merrill Lynch in the form of a loan, and Merrill Lynch would pay only $7 million in cash; (b) the transaction would allow Enron to book $12 million in year-end earnings, and for this reason had to close by December 31, 1999; and (c) Enron agreed to take out Merrill Lynch from the transaction within six months at a specified rate of return, 22.5%. Davis, Bayly, and others also discussed the fact that the transaction was very important to Enron. Davis knew that Enron was an important client of Merrill Lynch and that Enron had paid Merrill Lynch millions in fees in 1999 and was expected to do so again in 2000. Davis was also made aware by Bayly and others that there were concerns within Merrill Lynch about the propriety of the transaction, including the concerns raised before the DMCC. Davis was also informed by Bayly and others that the DMCC had not resolved these issues, had not approved the transaction, and that his approval would be necessary to enter into the transaction. Bayly, Davis, and others discussed the fact that Bayly was going to contact Fastow to confirm Enron's commitment to take Merrill out of the transaction. Davis instructed Bayly to make this call. After considering all of these facts, and knowing the transaction was a sham sale designed to allow Enron to record earnings, Davis approved the transaction. Davis and Bayly understood that it would not be necessary for Bayly to consult with Davis again to close the transaction once Bayly confirmed Enron's take-out commitment with Fastow.

27. Bayly called Fastow on or about December 23, 1999 to confirm the agreed upon take-out. Tilney and Furst, among others, participated in the call. These defendants also wanted to make sure that Fastow understood that Merrill Lynch was doing the transaction as a favor to Enron, and that Merrill Lynch would not be participating in the transaction unless it were trying to improve its business relationship with Enron. Fastow assured Merrill Lynch that it would not lose money and would be taken out of the deal within six months. Fastow stated that this guarantee could not be in writing as it would defeat Enron's ability to recognize a gain on the sale. After this call, Bayly directed others at Merrill Lynch to close the transaction with Enron.

Enron Records Fraudulent Earnings

28. Merrill Lynch invested $7 million, and Enron financed the remainder of the deal with a $21 million loan that was non-recourse to Merrill Lynch. Merrill Lynch never paid any interest on the loan. Defendants did not actively monitor the investment.

29. Enron recorded approximately $12 million of fictitious earnings in the fourth quarter of 1999 from the sale of the barge interest.

Course of Conduct Confirms Take-Out

30. Six months later, consistent with the guarantee given by Enron to Merrill Lynch, Fastow arranged for Merrill Lynch to be bought out of its interest in the barges. Internal Enron and Merrill Lynch documents dated in

the May-June 2000 time period confirm that Enron was obligated to take out Merrill Lynch by June 2000.

31. For example, a May 2000 Enron e-mail between Enron executives knowledgeable about the barge transaction states: "As we have discussed, should a strategic buyer not materialize by June 30, 2000, [ENRON] will have to take out ML and the investment in the barges will be placed on balance sheet. This will not only have income implications but require a level of damage control with AA [Arthur Andersen]. As you know, ML's decision to purchase the equity was based solely on personal assurances by Enron senior management to ML's Vice Chairman [Dan Bayly] that the transaction would not go beyond June 30, 2000."

32. In a later e-mail in the same e-mail chain, another Enron executive wrote to reiterate Enron's obligation to Merrill Lynch: "[t]o be clear, ENE [Enron] is obligated to get Merrill Lynch out of the deal on or before June 30. We have no ability to roll structure." In response, another executive wrote: "We have always understood that is required."

33. Another internal Enron e-mail confirms the take-out: "[t] he deal with ML was to get them a total annualized return of roughly 20%" and that "ML is expecting to receive a minimum of $7.525 million when they sell there [sic] equity on June 30, 2000."

34. In mid-June 2000, Furst and others at Merrill Lynch prepared a draft letter to Enron in anticipation of the agreed upon take-out. The letter referred to the barge transaction and stated: "Enron has agreed to purchase the [Enron] shares from Ebarge [the Merrill Lynch SPE] by June 30, 2000, for a purchase price . . . of $7,510,976.55." The letter also provided Enron wiring instructions and indicated the amount should be paid "on or before June 30, 2000." Merrill Lynch did not have to send the letter because on or about June 14, 2000, an Enron executive contacted Merrill Lynch and said that Enron had found a buyer for Merrill Lynch's interest for the "agreed upon amount."

35. Enron arranged for LJM2, a partnership operated by Fastow, to buy Merrill Lynch's interest. On June 29, 2000, LJM2 bought Merrill Lynch's interest for $7,525,000. The price was not the product of negotiation. Rather, the price reflected a $525,000 premium over Merrill Lynch's original investment to account for the rate of return promised to Merrill Lynch. As agreed, Merrill Lynch earned approximately a 22% annualized return on its $7 million investment. LJM2 documents confirm that it made the purchase to fulfill Fastow's guarantee.

The Energy Trade Transaction

36. Merrill Lynch, Furst, and Tilney also assisted Enron in another fraudulent year-end transaction in December 1999. In this transaction, Enron agreed to pay Merrill Lynch a $17 million fee to enter into a virtually offsetting energy trade. Merrill Lynch, Furst, and Tilney knew, among other things, that the transaction: (a) was essentially risk free to Merrill Lynch, and (b) had the purpose and effect of inflating Enron's reported income by approximately $50 million in 1999, and that such earnings were necessary for Enron to meet earnings targets and award bonuses to senior management. Merrill Lynch, Furst, and Tilney also knew that Enron was

contemplating unwinding the transaction after obtaining its earnings benefit. Knowing these facts, and to accommodate an important client, Merrill Lynch, Furst, and Tilney knowingly rendered substantial assistance to Enron in carrying out the fraudulent transaction. After the transaction was completed and Enron reported its inflated earnings, Enron and Merrill Lynch unwound the transaction on June 30, 2000, and Enron received $8.5 million, half of its original fee.

Enron Approaches Merrill Lynch With Proposed Energy Trade

37. In December 1999, the CEO of Enron North America contacted Merrill Lynch investment bankers to discuss a proposed electricity option transaction that Enron wanted to complete by year end. Furst and Tilney wanted to do the transaction to help Enron and sought approval within Merrill Lynch. Initially, a Merrill Lynch executive told Furst and Tilney that Merrill Lynch was unlikely to approve the deal because such transactions normally took weeks or months to analyze and complete. However, Merrill Lynch explored whether it could complete the transaction in the tight time frame based on Enron's importance as a client and the urgency of its request.

38. Enron supplied Merrill Lynch with summary documents for the proposed transaction. Enron designed a transaction structure using two "back to back" call options. Enron proposed to sell Merrill Lynch a physically settled call option. Simultaneously, Merrill Lynch would sell to Enron an offsetting financially-settled call option. The terms of the options were nearly identical.

39. Furst and Tilney helped draft a summary memorandum dated on or about December 29, 1999, describing the terms of the transaction. The memorandum stated that the transaction was one of Enron's highest priorities and would enable Enron to achieve "off-balance sheet" treatment for certain assets. The memorandum discussed the options to be sold by each party to the other, stating, "[t]he quantities, pricing points, market locations and term are `mirror image.'" In a portion addressing "risk," the memorandum stated, "[t]he proposed transaction is `back-to-back' and is therefore `delta-neutral.'" The memorandum also stated that Enron would pay a fee of $17 million based in part on "the benefits enjoyed by Enron as a result of the transaction," and the fee would be built into the option premiums paid by Enron. The memorandum closed with a recommendation to approve the transaction based on Enron's importance as a client, the millions in fees paid by Enron on other transactions, and the financial benefits to Merrill Lynch and Enron.

40. Merrill Lynch, Furst, and Tilney knew they could request a substantial fee from Enron because Enron was anxious to complete the transaction. Enron was initially surprised regarding the size of the fee because the transaction posed little risk to Merrill Lynch, but ultimately agreed to pay a $17 million fee given the importance of the transaction to its year end earnings.

Merrill Lynch Reviews And Approves Energy Trade

41. On or about December 30, 1999, Merrill Lynch's Special Transactions Review Committee (STRC) met to review the transaction. Prior to the

meeting, the STRC received the summary memorandum (see & 39 infra) prepared by Furst, Tilney, and another Merrill Lynch executive. The STRC reviewed the details of the transaction as described in the summary memorandum. The STRC also was informed that the transaction had no market risk and that the options offset each other. The STRC questioned, among other things, how Enron could use the transaction to achieve off balance sheet treatment for certain assets. The meeting adjourned so that more information could be obtained from Furst and Tilney.

42. While the STRC meeting was adjourned, Furst and Tilney had conversations with others at Merrill Lynch about questions raised at the meeting. Furst and Tilney then revealed to others at Merrill Lynch, for the first time, that Enron's purpose for the transaction was to achieve year-end earnings, not off-balance sheet treatment of assets. Merrill Lynch executives were angry and embarrassed at this revelation because they had given different information to the STRC. Once Enron's true purpose was known, a Merrill Lynch employee expressed reservations about the transaction because it appeared to him to be a ploy by Enron to manipulate its earnings. In response, another high level Merrill Lynch executive stated that Merrill Lynch had "17 million reasons" for getting the transaction approved.

43. When the STRC reconvened on or about December 30, 1999, Furst and Tilney joined the meeting by telephone. Furst and Tilney revealed to the STRC Enron's true purpose for the transaction -- to achieve year end earnings. Merrill Lynch also knew that Enron was accounting for the transaction in a different manner than Merrill Lynch was planning. Merrill Lynch viewed the transactions as offsetting with the only gain being the $17 million fee owed to Merrill Lynch. The STRC discussed how it could be that Enron intended to record a gain on the transaction. Concerned, Merrill Lynch attempted to create a record that it thought would shield itself from liability or exposure. The STRC expressed a desire to speak directly to Enron and its auditors, purportedly to confirm that Enron's accounting for the sham transaction had been approved.

44. Furst and Tilney contacted Enron's chief accounting officer (CAO) and asked him to speak to the STRC. Enron's CAO joined the STRC meeting by phone, introduced by Furst. Enron's CAO told Merrill Lynch that he was aware of the transaction, that Enron intended to take $50-60 million in earnings on it, that this was a material amount for Enron, and that it would affect bonuses of senior management at Enron. Enron's CAO also claimed that Arthur Andersen, Enron's auditors, had been consulted and had approved Enron's accounting for the transaction. Merrill Lynch requested that Enron provide a "warranty letter" stating that Andersen approved the transaction, that Merrill Lynch had provided no accounting advice to Enron, and that Enron had not relied on Merrill Lynch to determine the market value of the transactions. Merrill Lynch prepared the letter and Enron's CAO faxed the signed letter back to Merrill Lynch on December 31, 1999.

45. Merrill Lynch, Furst, and Tilney never talked to Andersen, and had no engagement or retainer with Andersen. Andersen provided no analysis or anything else about the transaction orally or in writing to Merrill Lynch, Furst, and Tilney. Merrill Lynch, Furst, and Tilney did not know whether Enron had fully disclosed to Andersen all facts about the transaction. These defendants fully knew, regardless of the purported "warranty letter," that

the transaction was a sham transaction intended to create year-end earnings for Enron.

46. After Merrill Lynch received the purported "warranty letter" from Enron, the transaction closed. Enron recognized nearly $50 million in earnings for the year end 1999.

The Parties Unwind The Energy Trade

47. In February 2000, less than two months after the transaction was agreed upon, Enron sought to unwind the transaction early. Furst sought guidance within Merrill Lynch on a fee for the early unwind (because the original fee of $17 million was not paid up-front but would be paid in the form of option premiums, beginning months later, in September 2000).

48. In May 2000, an Enron executive again asked Merrill Lynch to unwind the transaction, with no payment of the $17 million fee to Merrill Lynch. However, Furst and Tilney believed that Merrill Lynch should be compensated for the early unwind. An e-mail dated May 2000 written by Tilney and sent to Furst and others confirmed that the parties contemplated the unwind at the inception of the transaction, and that the purpose of the transaction was to help Enron make earnings:

> This is not a great surprise as [the ENA CEO] had indicated to Rob [Furst] and me at year-end when we did this trade that [Enron] thought they would want to unwind at some point. As you know, [the ENA CEO] has now moved on to a new position at Enron, and I for one am less concerned about the relationship issues as they knew what we were making at the time and we were clearly helping them make earnings for the quarter and year (which had great value in their stock price, not to mention personal compensation). What would you think was a fair number in the absence of relationship issues?

49. Furst and Tilney had conversations with a Merrill Lynch executive who wanted the full original $17 million fee to unwind the transaction. The Merrill Lynch executive, Furst, and Tilney met with Bayly on the issue. Bayly told the participants that Merrill Lynch should unwind the transaction early for a lower amount, because Enron was an important client and there were wider relationship considerations. Thereafter, Furst negotiated with Enron regarding the fee.

50. On June 30, 2000, the same time period at which Enron facilitated the take out of Merrill Lynch from the barge transaction, the energy trade was unwound. Merrill Lynch received $8.5 million for the unwind, half of its original fee for the transaction.

Effect of the Sham Transactions on Enron's Earnings and Merrill Lynch's Fees

51. Enron's fraudulent scheme, aided and abetted by defendants, resulted in Enron's recognition of approximately $60 million in income for the fourth quarter 1999 (improving net income from $199 million to $259 million, a 30% increase). The fraudulent transactions also increased Enron's 1999

earnings per share from $1.09 to $1.17. The fraudulent earnings were publicly reported in Enron's 1999 Form 10-K and were reflected in Enron's 10-Q for the first quarter of 2000, the results of which were later distributed and published by Enron numerous times. Since the fraudulent earnings enabled Enron to meet its 1999 earnings targets, they had a favorable impact on Enron's stock price and the amount of bonuses for Enron's senior management, and enabled Enron to raise millions of dollars.

52. Merrill Lynch earned $9.275 million in fees from the barge and energy trade transactions. Defendants' substantial participation in Enron's fraud resulted in continued business and fees for Merrill Lynch on other Enron engagements.

53. Merrill Lynch handsomely compensated Bayly, Davis, Furst, and Tilney, and their efforts for Enron were a factor in determining the amount of this compensation.

CLAIMS FOR RELIEF

FIRST CLAIM

Aiding and Abetting Violations of Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)] and Rule 10b-5 thereunder [17 C.F.R. § 240.10b-5]

54. Paragraphs 1 through 53 are realleged and incorporated by reference herein.

55. As set forth more fully above, Enron, directly or indirectly, by use of the means or instrumentalities of interstate commerce, or by the use of the mails and of the facilities of a national securities exchange, in connection with the purchase or sale of securities: has employed devices, schemes, or artifices to defraud, has made untrue statements of material facts or omitted to state material facts necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or has engaged in acts, practices, or courses of business which operate or would operate as a fraud or deceit upon any person.

56. As detailed above, defendants knowingly provided substantial assistance to Enron in violation of Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)], and Rule 10b-5 thereunder [17 C.F.R. § 240.10b-5].

57. Based on the foregoing, defendants aided and abetted violations of Section 10(b) of the Exchange Act [15 U.S.C. § 78j(b)], and Rule 10b-5 thereunder [17 C.F.R. § 240.10b-5].

SECOND CLAIM

Aiding and Abetting Violations of Section 13(a) of the Exchange Act [15 U.S.C. § 78m(a)] and Rules 12b-20, 13a-1, & 13a-13 thereunder [17 C.F.R. §§ 240.12b-20, 240.13a-1, 240.13a-13]

58. Paragraphs 1 through 57 are realleged and incorporated by reference

herein.

59. By engaging in the conduct described above, defendants knowingly and substantially assisted Enron to file with the Commission a false and misleading annual report on Form 10-K for 1999 and a false and misleading quarterly report on Form 10-Q for the first quarter of 2000.

60. By reason of the foregoing, defendants aided and abetted violations by Enron of Section 13(a) of the Exchange Act and Rules 12b-20, 13a-1, and 13a-13 thereunder.

THIRD CLAIM

Aiding and Abetting Violations of Sections 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act [15 U.S.C. §§ 78m(b)(2)(A), 78m(b)(2)(B)] and Rule 13b2-1 [17 C.F.R. § 240.13b2-1]

61. Paragraphs 1 through 60 are realleged and incorporated by reference herein.

62. By engaging in the conduct described above, defendants aided and abetted Enron's failures to make and keep books, records, and accounts which, in reasonable detail, accurately and fairly reflected Enron's transactions and dispositions of its assets, in violation of Section 13(b)(2)(A) of the Exchange Act, and further aided and abetted failures to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that Enron's corporate transactions were executed in accordance with management's authorization and in a manner to permit the preparation of financial statements in conformity with generally accepted accounting principles in violation of Section 13(b)(2)(B) of the Exchange Act.

63. By engaging in the conduct described above, Enron, directly or indirectly, falsified or caused to be falsified, books, records, and accounts subject to section 13(b)(2)(A) of the Exchange Act, in violation of Exchange Act Rule 13b2-1 and defendants aided and abetted Enron's violation of this rule.

64. By reason of the foregoing, defendants aided and abetted violations of Sections 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rule 13b2-1 thereunder.

FOURTH CLAIM

Aiding and Abetting Violations of Section 13(b)(5) of the Exchange Act [15 U.S.C. § 78m(b)(5)]

65. Paragraphs 1 through 64 are realleged and incorporated by reference herein.

66. By engaging in the conduct described above, defendants aided and abetted Enron's knowing circumvention or knowing failure to implement a system of internal financial controls at Enron.

67. By reason of the foregoing, defendants aided and abetted Enron's violations of Section 13(b)(5) of the Exchange Act.

JURY DEMAND

69. The Commission demands a jury in this matter.

PRAYER FOR RELIEF

WHEREFORE, the Commission respectfully requests that this Court:

A. Grant a Permanent Injunction restraining and enjoining defendants from violating the statutory provisions set forth herein; prohibiting Bayly, Davis, Furst, and Tilney permanently and unconditionally from acting as officers or directors of any issuer of securities that has a class of securities registered pursuant to Section 12 of the Exchange Act or that is required to file reports pursuant to Section 15(d) of such Act; ordering Merrill Lynch to pay disgorgement of illegal gains, and ordering all defendants to pay civil penalties;

B. Pursuant to Section 308 of the Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204 (2002), enter an order providing that the amount of civil penalties ordered against defendants be added to and become part of a disgorgement fund for the benefit of the victims of the violations alleged herein; and

C. Grant such other and additional relief as this Court may deem just and proper.

Dated: March ___, 2003

Respectfully submitted,

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Director, Enforcement Division
Linda Chatman Thomsen
Deputy Director, Enforcement Divisio
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http://www.sec.gov/litigation/complaints/comp18038.htm

The Wall Street Journal

Tuesday, April 9, 2002

Enron's McMahon: Hero or Collaborator?

Current Company President Took Part in a Sale That Helped Give Profits an Artificial Boost

By Anita Raghavan

In recent congressional hearings, Enron Corp. President Jeffrey McMahon was touted as an executive-suite hero who early on questioned the propriety of the firm's controversial partnership arrangements. In one exchange on Capitol Hill in February, Sen. Olympia Snowe (R., Maine) said she wished there had been more Sherron Watkinses and Jeffrey McMahons at Enron "because it might have well prevented this catastrophic demise of one of the largest companies in America."

But there are a few things lawmakers didn't ask Mr. McMahon about -- and he didn't offer up.

Two years before Enron imploded, Mr. McMahon was involved in a sale of several Nigerian barges to brokerage firm Merrill Lynch & Co. that helped Enron artificially boost its profits and contributed to the company's misleading financial picture. And in the summer of 2000, Mr. McMahon attempted, unsuccessfully, to set up a separate partnership to package some slow-growing businesses off Enron's books.

No one is suggesting that Mr. McMahon enriched himself through these activities, the way some Enron executives did. Yet other Enron executives involved in controversial activities have left the energy firm. Mr. McMahon, 41 years old, not only remains at Enron; in January, he was named president and has been commended for questioning the conflicts of interest raised by the partnerships set up by former Enron Chief Financial Officer Andrew Fastow, in which Mr. Fastow had an ownership interest.

But, like other senior executives at Enron, Mr. McMahon, who was Enron's treasurer between 1998 and late March 2000, painted a much-rosier picture of the company's finances than turned out to be true. Last month, an official at a major Wall Street credit-rating concern testified that Mr. McMahon was among the Enron officials who purposely misled the firm. During a January 2000 presentation to Standard & Poor's, Mr. McMahon offered the "kitchen sink" -- but failed to mention controversial partnerships that hid millions of dollars of off-balance-sheet assets from investors, Ronald Barone, an S&P managing director, told Congress. Included in Mr. McMahon's David Letterman-style list of "top 10 reasons" to upgrade Enron's credit rating was: "Communication with analysts, investors and credit officers is direct and candid -- No Secrets Policy," according to documents submitted as part of S&P's testimony.

Mr. McMahon also attempted to refute "common misperceptions" about Enron. Among them, the documents show, was this: "Myth: There are massive amounts of debt that is not included in Enron's credit profile. Fact: The inclusion of all obligations (without adjustment for non-recourse) does not materially change the financial profile of Enron."

Mr. McMahon declined to comment for this article. Mark Palmer, an Enron spokesman, says "it is fantastic to believe that S&P's understanding of the company hinged on one presentation." He says Mr. McMahon's description of the company's debt load was an accurate representation of its obligations at the time and he notes that the "kitchen sink" analysis referred to an explanation, which S&P requested, of a footnote in the company's annual report: "They asked for this information and we put it together in a presentation and 2 1/2 years later they are claiming we didn't answer a question they didn't ask."

What could put the spotlight on Mr. McMahon even more is the Merrill transaction, and Mr. McMahon's role in it. The deal wasn't just another example of Enron hiding assets off the books. It also involved a verbal pledge by Enron, and Mr. McMahon, to arrange for the investment to be bought back, say people familiar with the situation. That raises the question of whether the deal was, in effect, a "sham" transaction simply to allow Enron to book an earnings gain.

"This looks like manufactured earnings," says John Coffee, a Columbia University law school professor. He says that the principal violation of securities laws, if any, would be by Enron, which is "fabricating a structure where they can call it a sale" and thereby book an earnings gain.

"C"

It all began in mid-December 1999, when Mr. McMahon approached Merrill with a curious request, say people familiar with the situation. Would Merrill invest in the three electricity-producing barges, to be anchored off the coast of Nigeria? Mr. McMahon asked.

It was Enron's plan, these people say Mr. McMahon said, to arrange for Merrill's $7 million investment to be bought back in the coming months. But Mr. McMahon said Merrill had to move quickly: Enron wanted to close the deal by year end so it could book an anticipated $12 million earnings gain from the deal, the people say. In December 1999, Enron created a special-purpose vehicle for the barges, contributing $21 million of debt to it and $7 million of equity from Merrill. The exact gain Enron booked from the deal is not known.

Merrill says it made the investment to please a major client. And, sure enough, an Enron partnership bought back the investment seven months later. Now the Securities and Exchange Commission and congressional investigators probing the Enron matter are examining the Nigerian barge deal to see if it was done simply to temporarily, and artificially, bulk up Enron's earnings, ultimately helping to conceal the Houston energy company's changing financial picture from investors.

Mr. McMahon's call to Merrill came after the Enron executive had pitched bankers at other securities firms without success. In one conversation with a Wall Street investment banker, Mr. McMahon stressed the urgency and assured the banker that "we'll make sure you'll get taken out" in the first half of 2000, suggesting Enron would buy back the investment, if necessary, according to a person who heard the pitch.

Mr. Palmer says Mr. McMahon's "involvement in the transaction was entirely legitimate. Jeff didn't promise nor does the documentation support that anybody would be guaranteed a rate of return." Mr. McMahon wouldn't comment.

The Nigerian deal, albeit small, came at a time when Enron appeared to be padding its profits with sales of assets to LJM1 and LJM2, two partnerships central to the company's downfall. "Near the end of the third and fourth quarters of 1999, Enron sold interests in seven assets to LJM1 and LJM2," according to a report by a special committee of Enron's board. The asset sales to LJM1 and LJM2 "were done quickly and permitted Enron to remove assets from its balance sheet and record a gain in some cases." The report quoted Mr. Fastow as saying in a presentation to the board's finance committee that the LJM transactions generated, directly, or indirectly, "earnings" to Enron of $229 million in the second half of 1999.

Mr. McMahon indicated to Merrill that Enron had been negotiating to sell the revenue streams thrown off by the barges to a third party. But a sale had been delayed because the buyer wouldn't sign on until Enron had reached a power- purchase accord with the Nigerian government, with which it was simultaneously negotiating, say people close to the matter.

Merrill now says it believed the deal was "appropriate" given what it knew about Enron at the time. It says it viewed the deal as providing bridge financing to accommodate a client with which it wanted to cultivate a relationship. The transaction was "carefully reviewed" and, in the end, a Merrill spokesman says: "We concluded that it was appropriate given what we knew about Enron at the time. We felt it was a real transaction with real risk consistent with Enron's core business." The Merrill spokesman says the deal was fully vetted by the firm's banking, credit and legal departments and was a small transaction immaterial to Merrill and Enron. Merrill also confirms that Mr. McMahon "made the formal request on this and was involved in it."

Mr. McMahon's overture to Merrill is documented in transaction notes Merrill recently handed over to the SEC. The notes say that "Jeff McMahon, EVP [executive vice president] and treasurer, has asked Merrill Lynch to purchase $7 million of equity in a special-purpose vehicle that will allow Enron to book $12 million of earnings." The notes also indicate that the proposed transaction has a maturity date of six months. By selling the barges to a special-purpose vehicle, Enron could book a gain on the asset, reflecting the difference between the value at which it was carried on its own books and the price at which it was sold to the special purpose vehicle, accountants explain. For arranging the deal, Merrill earned $250,000; when the investment was sold seven months later, Merrill received an additional $525,000.

In June 2000, after Mr. McMahon had left the treasurer's job, Enron executive Dan Boyle told Merrill it had found a buyer for its equity stake in the

Nigerian barges -- Enron's own LJM2 partnership, say people familiar with the situation. On June 29, 2000, LJM2 bought the investment for $7.5 million, and, in September, LJM2 sold the investment for $8.2 million to power company AES Corp. and pocketed a $700,000 profit, LJM partnership documents show. Mr. Boyle declined to comment.

To be sure, other Enron officials were involved in the Nigerian deal. In another conversation with Merrill -- cited in interview transcripts done for an internal investigation conducted by a special committee of Enron's board -- a senior director of transaction support at Enron said he was told by Mr. Boyle that during the 1999 talks with Merrill, Mr. Boyle "particicpated in a phone call in which Andy Fastow gave Merrill Lynch a verbal assurance that he would make sure Merrill Lynch was relieved of its interest in Nigeria Barge by June 2000." Mr. Fastow, through a spokesman, declined to comment.

The Nigerian transaction also underscores the degree to which Wall Street firms helped Enron create its complex and misleading financial structure -- a topic that is likely to draw congressional scrutiny in months ahead. The House Energy and Commerce Committee sent letters last month to more than a dozen securities and credit-rating firms seeking records about Enron and its partnerships, and a Senate panel grilled Wall Street analysts who recommended Enron's stock last fall as the company headed toward a bankruptcy-court filing.

Since Enron's troubles have surfaced, Mr. McMahon has tried to distance himself from its problems, even though he was publicly bullish on the stock just months before the firm's collapse. For instance, Mr. McMahon painted a glowing picture of Enron on Sept. 20 and Oct. 18, 2001, during two visits to his alma mater, the University of Richmond. So bullish was Mr. McMahon that managers of a university student fund say they sank nearly $13,000 in Enron.

"He was going on and on about how undervalued the stock was that you would have never thought there was something wrong at the company," says Devin Weisleder, one of the 11 student managers of the $90,000 Student Managed Investment Fund, or Spiderfund, "value" portfolio. The fund lost nearly all its investment when Enron filed for bankruptcy-court protection in December. The fund sold the stock at 83 cents after buying 1100 shares at about $11.61 a share.)

When Mr. McMahon was asked about his rosy portrait of Enron by the student newspaper, the Collegian, he said in an interview on Jan. 30, 2002, that he was "running an operating division at the time [of his first visit], responsible for paper and steel." Enron's Mr. Palmer said Mr. McMahon was responding to a question that assumed he was the finance chief at the time of the presentations. Mr. McMahon delivered a company-prepared and approved presentation, the accuracy of which he had no reason to doubt, Mr. Palmer said.

Still, Joe Ben Hoyle, Mr. McMahon's former accounting professor at the university, remains puzzled by his pupil's comments. "You'd think with a guy who is that high up in the company, if he tells you to buy the stock, the company won't go bankrupt," he says, adding that Mr. McMahon's bullish comments came "very late in the game."

Meantime, Mr. McMahon also had a hand in other Enron practices that now are being questioned. In the summer of 2000, he attempted to set up a partnership to move Enron's slow-growing pulp and paper business, among other things, off the books and develop them without reflecting the costs on Enron's consolidated income statement. The planned $1 billion partnership, Enron Net Works Partners, would pursue acquisitions in base metals, pulp and paper, lumber and steel industries, according to a confidential private-placement document from underwriter Chase H&Q, now a unit of J.P. Morgan Chase & Co. Mr. McMahon was slated to be president and chief operating officer of Net Works. (Net Works never got off the ground because Chase H&Q couldn't raise the money from investors for the partnership.)

Mr. Palmer says the company's strategy was to develop these businesses with outside capital. "You can question that corporate strategy but I don't see how you can question Jeff McMahon for carrying it out," says Mr. Palmer.

Still, "there is no legitimate reason" that the assets in Enron Net Works should be housed off balance sheet, says Edward Ketz, an accounting professor at Pennsylvania State University.

Responds Enron's Mr. Palmer: "If there is third party equity involved, and there is a true transfer of risk, it's entirely legitimate."

Robert Block and Michael Schroeder contributed to this article.

In Defense of Enron

Above are the top reasons that Enron's then-treasurer, Jeffrey McMahon, gave to Standard & Poor's two years ago when, in a David Letterman-style top 10 list, he enumerated why the credit-rating agency had underrated Enron.

His Top Five Reasons Why Enron Is Underrated

5 Over the past 10 years, Enron's performance has demonstrated a low risk business strategy in a highly volatile commodity/energy market.

4 Enron's financial ratios vs. peer companies are favorable,especially considering Enron's competitive advantage with respect to market shares and control systems.

3 Bond spreads/bank spreads indicate A- risk weighting.

2 Communication with analysts, investors, and credit officers is direct and candid -- No Secrets Policy.

1 Enron's credit rating is critical to the maintenance and growth of its existing dominant market share position.

Enron Corp. Credit Conference
Credit Profile
January 29, 2000
Jeffrey McMahon
Executive Vice President, Finance and Treasurer

---- INDEX REFERENCES ----

COMPANY (TICKER): Enron Corp.; ENRNQ; Merrill Lynch & Co. (ENE ENRNQ MER)

NEWS SUBJECT: Energy Markets; Bankruptcy; Bankruptcy; Corporate Actions; Corporate/Industrial News; Divestitures or Asset Sales; Divestitures/Asset Sales; Newspapers' Section Fronts; High- Yield Issuers; Natural Gas; Management Issues; Management Issues; Dow Jones Total Market Index; Wall Street Journal; English language content; Domestic Politics; Political/General News; Politics; Commodity Markets; Market News; Ownership Changes (M143 BCY C16 CAC CCAT DVT C182 FRT HIY LNG MNT C41 WEI WSJ ENGL GPOL GCAT PLT M14 MCAT C18)

MARKET SECTOR: Financial; Utilities; Newswire More Code; Newswire End Code (FIN UTI MMR NND)

INDUSTRY: Electric Utilities; Gas Utilities; Securities; Dow Jones Sector Titans Index - Financial (ELC GAS SCR XSTF)

REGION: North American Power; United States; North American Electric Reliability Council; North America; New York; United States - New York; Texas; United States - Texas; United States; Northeast U.S.; Southern U.S.; North American Countries (NAPW USA NERC NME NY USNY TX USTX US USE USS NAMZ)

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The New York Times

Mark *The New York Times*, August 8, 2002 pA1(L) col 02 (46 col in)

Ex-Executives Say Sham Deal Helped Enron. (Business/Financial Desk) *David Barboza.*

Desperate to meet a year-end profit target, the Enron Corporation struck a sham energy deal with Merrill Lynch that let Enron book a $60 million profit in the final days of December 1999, according to former Enron executives involved in the transaction.

The executives said that the energy deal, a complex set of gas and power trades, was intended to inflate Enron's profits and drive up its stock price. Enron and Merrill Lynch, they said, agreed that the deal would be canceled after Enron booked the profits; it later was.

By allowing the company to meet its internal profit targets, the power deal unleashed the payment of millions of dollars in bonuses and restricted stock to high-ranking executives, including Kenneth L. Lay, then the chief executive, and Jeffrey K. Skilling, then Enron's president, former executives said.

"This was absolutely a sham transaction, and it was an 11th hour deal," said one former Enron executive who was briefed on the deal. "We did this deal to get 1999 earnings." This account was confirmed by five other former executives who either worked on the deal or were briefed on it. All the executives insisted on anonymity, concerned either about losing their current jobs or being drawn into the litigation over Enron's collapse.

Merrill Lynch officials said there was nothing improper about the power deal and no prearrangement to cancel it, and one former Enron executive involved in the deal agreed.

"The trades we conducted with Enron were legitimate transactions involving real risk," Merrill said in a statement today. "At no time did Merrill Lynch knowingly assist Enron in misstating revenues."

Yet Merrill executives were so concerned about Enron's accounting for the deal that they obtained a letter signed by Richard A. Causey, Enron's chief accounting officer, stating that Enron did not rely on Merrill Lynch for accounting advice, former executives said. Securities law experts said that such a letter could help Merrill defend itself against any fraud charges that might arise from the transaction.

The deal was five times as big as Enron's sale of a Nigerian power barge to Merrill Lynch the same month, a transaction that a Senate panel denounced last week as evidence that the Wall Street bank helped Enron inflate its profits and cook its books.

Both of the December 1999 deals came as Enron struggled to meet Wall Street's year-end profit expectations. With the profits from the deals, Enron on Jan. 18, 2000, reported a fourth-quarter profit of $259 million, or 31 cents a share, matching analysts' expectations. Without the $60 million profit, the company would have reported earnings of about 24 cents a share, according to Charles Hill, director of research at Thomson First Call, which tracks corporate profits.

"There are times when missing by a penny is huge," Mr. Hill said. "This would have creamed the stock." Instead, by the end of that week, Enron's share price had climbed 27 percent.

"D"

For its role in the deal, Merrill Lynch received about $8 million from Enron, people close to the transaction said.

Securities law experts said the transaction, which involved a series of complex gas and power trades, may have violated securities laws by allowing Enron to manipulate its year-end profit statement.

"Not only could this be securities fraud, but you could have a looting of the stock plan," said John C. Coffee Jr., a professor of law at Columbia University. "This could have been a way of fabricating earnings to permit the executives to reap stock bonuses. That's rigging the scoring system."

At the time, moreover, Merrill Lynch's sales force was promoting Enron's stock and the bank's private equity group -- touting Enron's stellar performance -- was asking investors to contribute over $250 million to one of Enron's off-balance-sheet partnerships.

Lawmakers have criticized Merrill Lynch and other banks that did business with Enron for having been blind to conflicts between the interests of their banking clients and those of investors. Merrill said today that the "Chinese walls" between its various businesses kept information about the power deal away from its sales force.

A spokesman for Enron, now in Chapter 11 bankruptcy protection, declined comment. Arthur Andersen, which as Enron's auditor at the time approved the accounting for the power deal, also had no comment. A spokeswomen for Mr. Lay declined comment and a spokeswoman for Mr. Skilling could not be reached..

The deal originated in Enron North America, the company's trading unit, where executives conceived a plan to take advantage of a group of power plants under construction in the Midwest. Their notion, the former executives said, was that if Enron could sell contracts tied to the output of some of the plant's well in the future, the company could book the long-term profits immediately, even if it did not receive a dime up front.

But when no energy company could be found to participate in such a deal, former executives said, Enron turned to its banker, Merrill Lynch, which operated its own energy trading unit.

The Enron effort was headed up by J. Clifford Baxter, the chairman and chief executive of Enron North America. One of his contacts on the deal at Merrill was Schuyler M. Tilney, the investment banker who last week invoked his Fifth Amendment right against self-incrimination and refused to testify before the Senate Permanent Subcommittee on Investigations. A lawyer for Mr. Tilney declined comment.

The initial plan for the power deal, the executives said, was to create a kind of mirror swap in which Enron would purchase energy contracts from Merrill and Merrill would simultaneously purchase energy contracts from Enron. But Arthur Andersen and Merrill Lynch were troubled by the structure of that deal, former executives said, worried that it amounted to a wash transaction from which no profits could be claimed.

With time winding down on the fourth quarter, Enron put pressure on Merrill and the Andersen accountants to help it complete some kind of deal.

"People were working 14-hour days, and Andersen was working around the clock to get this deal done," said one former Enron executive who was briefed on the transaction. "This deal got done in 10 days."

Enron and Merrill restructured the power deal as a complex series of gas and power contracts over four years. The executives' recollections differ on some accounts. But three executives briefed on the deal said that Enron and Merrill executives discussed canceling it in the first quarter of 2000, months before Merrill's first scheduled payment that September.

To further insulate Merrill, Enron agreed to embed a fee of about $14 million in the power contracts, former executives said.

The former executives said that Andersen accountants opposed elements of the final deal and warned Enron that if no gas was delivered in 2000, they might force the company to restate its 1999 earnings. Andersen officials who asked not to be named said this week that the firm told Enron only that auditors might have to consider the possibility of a restatement.

Tempers flared, some of the former executives said, as end-of-the-quarter pressure mounted on high-level executives including Mr. Baxter. Mr. Causey's letter to Merrill formally sealed the deal on Dec. 30, 1999.

Mr. Baxter committed suicide early this year. A lawyer for Mr. Causey declined to comment.

One Enron executive involved in the transaction disputed that the deal was a sham. Agreeing with Merrill Lynch, he said that there was a real transfer of risk to the investment bank, and he noted that there was no formal sale-buyback agreement.

"You will not see that in the contract," the executive said.

But in April 2000, Enron agreed to pay Merrill $8 million to cancel the deal, months before Merrill was scheduled to make a cash payment to Enron for the physical delivery of gas. Andersen did not press for a restatement of 1999 earnings, the former Enron executives said.

Enron executives benefited tremendously from the deal. Because Enron met its profit targets, dozens of top executives -- including Mr. Lay, Mr. Skilling and Mr. Baxter -- collected millions in stock and bonuses. Moreover, in the two weeks after the Jan. 18 earnings announcement, 20 Enron executives and directors sold $82.6 million in stock.

The deal was also a boon to Merrill Lynch's energy trading operation, which Merrill sold in January 2001 to Allegheny Energy Inc. for about $500 million.

Two weeks ago, Allegheny said it would shrink the operation because of the turmoil in the energy trading business. For its part, Merrill said in its statement today that it rued its dealings with Enron.

"We relied on representations made by Enron that it and its outside auditors had approved its transactions," Merrill said. "Like many others, we were deceived by Enron, and had we known what we know today, we would not have done business with them."

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